Congressional Research Service
Informing the legislative debate since 1914

IN FOCUS

March 1, 2024

The Tax Credit Exception for Leased Electric Vehicles

The Inflation Reduction Act (P.L. 117-169) created or modified three tax credits for purchases of electric vehicles (EVs): the clean vehicle credit (CVC), the used clean vehicle credit (UCVC), and the credit for qualified commercial clean vehicles (CQCCV). These credits may contribute to both the reduction of greenhouse gases and the promotion of domestic industry, policy initiatives that at times can conflict with each other.

This In Focus describes one such conflict: the exception for leased electric vehicles. Since businesses have the ability to receive tax credits for a broader group of electric vehicles leased to customers, car dealers may pass tax savings to individuals who lease vehicles that are ineligible for the CVC. Because the CVC has certain "made in America" requirements and other restrictions not present in the CQCCV, the leased vehicles exception may promote larger emissions reductions at the expense of domestic industry.

Clean Vehicle Credit Requirements

The CVC allows taxpayers to receive up to $7,500 for purchasing new EVs. Eligible EVs must be made by a qualified manufacturer, weigh less than 14,000 pounds, have four or more wheels, and be intended for use on public streets, roads, and highways. Electric boats, motorcycles, and bicycles do not qualify.

The CVC does not apply to all EVs. Rather, it applies to EVs meeting certain domestic content and manufacturing requirements. The $7,500 total credit is the sum of two smaller credits: a $3,750 credit for vehicles meeting the *critical minerals requirement* and a $3,750 credit for vehicles meeting the *battery components requirement*. To meet the critical minerals requirement, a certain percentage of the critical minerals in an eligible EV's battery must have been extracted or processed in the United States, extracted or processed in a country with which the United States has a free trade agreement, or recycled in North America. To meet the battery components requirement, a certain share of an EV battery's component parts must be manufactured or assembled in North America. The applicable percentages for both requirements are shown in **Table 1**. If a car meets just one requirement, it is eligible for a $3,750 credit.

EVs must meet additional domestic requirements to qualify for the CVC. First, eligible EVs must undergo final assembly in North America. Second, starting in 2024, none of the battery components in credit-eligible vehicles may have been manufactured or assembled by a foreign entity of concern (FEOC) (a company significantly influenced by the governments of China, Russia, Iran, or North Korea). Third, starting in 2025, none of the critical minerals in an eligible EV's batteries may have been extracted, processed, or recycled by an FEOC. If any of these conditions is violated, vehicles become ineligible for even partial credits. **Table 1** summarizes the five domestic content and manufacturing requirements in the CVC.

Table 1. Domestic Content and Manufacturing Requirements in the Clean Vehicle Credit, by Year

	North American Final Assembly	Battery Components		Critical Minerals	
		Domestic Content	FEOC Ban	Domestic Content	FEOC Ban
2023	Yes	50%	N.A.	40%	N.A.
2024	Yes	60%	Yes	50%	N.A.
2025	Yes	60%	Yes	60%	Yes
2026	Yes	70%	Yes	70%	Yes
2027	Yes	80%	Yes	80%	Yes
2028	Yes	90%	Yes	80%	Yes
2029	Yes	100%	Yes	80%	Yes
2030	Yes	100%	Yes	80%	Yes
2031	Yes	100%	Yes	80%	Yes
2032	Yes	100%	Yes	80%	Yes

Source: Internal Revenue Code §30D.

Notes: Vehicles acquired after August 16, 2022, must undergo final assembly in North America. The domestic content requirements and FEOC bans apply based on the year a vehicle is placed in service. The domestic content requirements denote (a) the share of an EV's battery components that must be manufactured or assembled in North America; and (b) the share of critical minerals in the EV's battery that must be extracted or processed in the United States, extracted or processed in a country with which the United States has a free trade agreement, or recycled in North America. The clean vehicle credit does not apply to vehicles placed in service after 2032.

In addition, taxpayers must have modified adjusted gross incomes at or below certain thresholds in either the year they claim the credit or the year before. The thresholds are $150,000 for single individuals without dependents, $225,000 for single individuals with dependents (known as "heads of household"), and $300,000 for married couples.

Finally, vans, SUVs, and pickup trucks with manufacturer suggested retail prices (MSRPs) above $80,000 do not qualify for the CVC, nor do other vehicles with MSRPs above $55,000. One rationale for such ceilings could be to prevent high-wealth, low-income individuals (such as heirs

or wealthy retirees) from claiming the credit when purchasing expensive EVs.

Businesses may also claim the CVC, but as discussed below, they will generally instead claim the credit for qualified commercial clean vehicles. The two credits cannot be claimed for the same vehicle.

Leased Vehicles and the Avoidance of Clean Vehicle Credit Requirements

In lieu of the CVC, businesses purchasing new EVs may choose to claim the CQCCV. The CQCCV is calculated differently from the CVC, is not subject to domestic content or manufacturing requirements, and can be claimed for vehicles used in the ordinary course of business or leased to customers.

The CQCCV may be claimed for all-electric vehicles, fuel cell vehicles, and certain hybrid electric vehicles. The credit differs by vehicle type, as discussed below:

- For hybrid vehicles, the credit equals the incremental cost of the vehicle or 15% of the vehicle's cost, whichever is lower;
- For all-electric and fuel cell vehicles, the credit equals the incremental cost of the vehicle or 30% of the vehicle's cost, whichever is lower.

A vehicle's incremental cost is defined as the additional cost for an electric, hybrid, or fuel cell vehicle as compared with a gas- or diesel-fueled vehicle of similar size and use. Hybrid and all-electric vehicles must have a battery capacity of at least 7 kilowatt hours if they weigh less than 14,000 pounds and at least 15 kilowatt hours if they weigh 14,000 pounds or more. The CQCCV may not exceed $7,500 for a vehicle weighing less than 14,000 pounds. For vehicles weighing 14,000 pounds or more, the CQCCV may not exceed $40,000. Certain heavy-duty vehicles ineligible for the CVC may therefore qualify for CQCCVs.

The CQCCV is nonrefundable, meaning that businesses are not entitled to a refund if their tax credits exceed their tax liabilities. However, any unused credits may be carried forward to offset future tax liabilities. Tax-exempt organizations are eligible to receive the credit as a direct cash payment instead of as a nonrefundable tax credit.

The CQCCV does not have any domestic content or manufacturing requirements. Qualifying vehicles need not be assembled in North America, nor must they draw their battery components or critical minerals from domestic sources. Battery components and critical minerals may also be purchased from FEOCs. Moreover, subsection (d)(1) of Internal Revenue Code (IRC) Section 45W—the section authorizing the CQCCV—states that the income and price limits from the CVC do not apply to the CQCCV.

If the CQCCV were claimed only for vehicles used in the ordinary course of business—for example, vehicles used to transport goods from one place to another—then it would not be in potential conflict with the requirements in the CVC. Businesses would claim the CQCCV, and individuals would claim the CVC, with the two credits simply having different requirements.

However, IRC §45W(c)(1) states that vehicles "acquired for use or lease by the taxpayer and not for resale" are eligible for the CQCCV. Due to the phrase "or lease," car dealers have begun claiming the CQCCV for vehicles they lease, then passing some or all of the benefits to consumers through discounts or price reductions.

This tactic has been applied to vehicles not eligible for the CVC. For example, Hyundai advertises lessees' ability to receive a "$7,500 EV Lease Bonus" for the Ioniq 5 SE Standard Range, which is not manufactured in North America. Dealers and manufacturers say they pass the credit to consumers for dozens of leased EV models, including EVs above the MSRP limits and EVs manufactured outside North America. (Hyundai leases more than 40% of its EVs, up from just 5% before certain domestic CVC restrictions began taking effect.) Finally, over half of EV drivers have household incomes above $100,000, and roughly one-third have incomes above $200,000, suggesting that some taxpayers above the CVC income limits could utilize the leased vehicles exception.

The economic benefits of the leased vehicles exception will likely be split between lessees, car dealers, and other businesses along the EV supply chain based on a variety of factors. For example, if a car dealer reduces the down payment on a leased EV by $1,000 in response to the CQCCV, then the lessee gains $1,000, while the dealer gains the remaining $6,500. Conversely, if a car dealer lowers the down payment by $6,500, then the lessee would receive a $6,500 benefit, while the dealer would receive $1,000. Insofar as the leased vehicles exception boosts demand for EVs, some of the gains may also be passed to car manufacturers or suppliers of raw EV materials. This is especially true of foreign-sourced materials that cannot be included in CVC-eligible vehicles.

Nicholas E. Buffie, Analyst in Public Finance

IF12603

Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS's institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.